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Pascal Grouiez*

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*LEMNA - Université de Nantes

INSTITUT d'ECONOMIE et de MANAGEMENT de NANTES - IAE

Laboratoire d'Economie et de Management Nantes-Atlantique
Université de Nantes
Chemin de la Censive du Tertre – BP 52231
44322 Nantes cedex 3 – France
www.univ-nantes.fr/iemn-iae/recherche
Tél. +33 (0)2 40 14 17 17 – Fax +33 (0)2 40 14 17 49

UNIVERSITÉ DE NANTES

Farming strategies regarding the production of collective goods in the Russian agricultural sector

Grouiez Pascal*

This article discusses the fact that as Russian farms have been developing multifunctionalities since 1991 this has to be considered as a twofold strategy: the first goal being expand the activities of some institutionally selected enterprises and the second being to reproduce some "communities of interests". The primary observation highlights a characteristic fact: there are several "non-economic" functions carried out by farms that depend on their nature (type of ownership, size of the farm, etc). This analysis leads to the establishment of a link between the very nature of these functions and the existence of constraints and opportunities offered by the economic and social environment. Then, the concept of "productive configuration" is applied to study organization strategies used by several actors in the Orel *oblast'* and to identify four strategies organizing the relationship between food production and collective welfare creation, each configuration showing an institutional arrangement to secure the continuity and development of farms in a highly competitive context.

Productive Configuration, Mutlfunctionality, Agroholding in Russia
JEL codes: L25, L51, O17, Q13, Q18.

1. INTRODUCTION

The concept of "corporate social responsibility" (CSR) is now widespread in economic literature. In an article published in 2006, PORTER AND KRAMER demonstrate that prevailing approaches to CSR are generally disconnected from the business and strategy of firms. In fact, CSR is mostly considered as a cosmetic response when local problems appear, due to the impact of a firm on society or its environment. In other words, it is more or less an aggregation of "anecdotes about uncoordinated initiatives to demonstrate a company's social sensitivity" (PORTER AND KRAMER 2006: 3). As Porter and Kramer did, we have analyzed the social responsibility behavior of firms from a more strategic point of view. Within the agricultural sector, another concept enables us to achieve this goal: the concept of multifunctionality.

As described below, there are two approaches to the analysis of multifunctionality. The first one is used by the OECD (2001) which defines it as the fact that the farms not only produce foodstuffs but also produce non-commercial goods, the main characteristic of these goods being that they are inseparable from commercial good production, because of the economies of scope. This is why non-commercial goods production by farms is supported by countries at the WTO to justify subsidies in the agricultural sector. With the OECD's definition of multifunctionality, "non-commercial goods" seem to be a characteristic of economic activity. The particular characteristic that makes an economic activity multifunctional is the multiple nature and interconnections of its outputs and effects.

A second understanding of multifunctionality makes these a much more strategic production. It considers the non-commercial output production as an objective assigned to the agricultural sector. Then, it becomes necessary to suppose that multiple roles were entrusted to the agricultural sector

* Assistant Professor, Université de Nantes, laboratoire du LEMNA, pascal.grouiez@univ-nantes.fr

and that multifunctionality has value in itself. In this article we will follow this second understanding of multifunctionality.

Yet, in both cases this non-commercial production largely appears as a public policy in support of agriculture and not as strategic private initiatives arising from farm management. For instance, AMELINA (2000, 2002) considers that the persistence of farms' social responsibility is only due to politicians' objective of winning votes. As a consequence, they support corporate farms without any economic consideration. In this article we would like to suggest another way to explain the maintaining of corporate farms and their socially responsible behavior, a way in which multifunctionality appears as a strategy of farms themselves. We believe that it is the same strategy that explains and enables the cohabitation of very different types of farms (in terms of size, productivity, etc.) within the agricultural sector.

To analyze multifunctionality as strategic farm behavior , we used an "industrial-organization-wise" approach in which we consider that the actor has a specific rational industry-oriented frame of reference. Within it an autonomous actor is able to reach a compromise between his own interests and the interests of some other actors in their community. We define a community as an institution that stands between individuals and the "mesosystem" (DE BANDT 1991) and that encourages group members to negotiate and reach a compromise, in order to preserve heritage. Heritage is an asset or an institution used to provide and sustain the vitality of a community (POLANYI 1943). The community has an impact on the nature of the supply chain that integrates both questions of the marketable goods' "production" (*commercial relationship*) and of the community members' "reproduction" *(patrimonial relationship)* (rural population, farms of different natures, oligarchs, manufacturing firms, etc.). This continuity of the communities can occur through the financing of collective goods by the farms. To describe the form taken by this institutional arrangement and its consequences on the supply chain management, we will use the terminology of "productive configuration" which comes from the French *régulation* theory. A productive configuration is a social framework that organizes the coherence of some institutional elements (such as laws, political choices, territorial issues, market rules, etc.) with the diversity of interests of actors into a community. It is a particular economic system in which capital organizes and expands at a sectoral level through production, circulation, consumption, and distribution for a period of time, with some degree of stability[1]. Due to the current period of transition in the Russian agricultural sector, in this article we will demonstrate that there is competition between different patterns of "productive configurations" in the area of the Orel *Oblast'*. As a result, multifunctionality takes different forms. For instance, different productive configurations maintain different types of large corporate farms. Some of corporate farms play a social role whereas others do not. With this approach in mind, we will demonstrate that the need of providing community vitality prompts authorities to subsidize more the farms that also play a social role.

In the first part of this article, we point out that multifunctionality is a characteristic or stylized fact of the Russian agricultural sector. We define a stylized fact as a recurrent observation on which the analyst focuses to investigate an economic issue. We will see that multifunctionality in Russian agriculture takes a form that has never been observed in other countries (particularly in the West). Then, we focus on the multifunctionality phenomenon itself to understand why the transition to market economy did not lead to corporate farms' bankruptcy as expected but, on the contrary, to the diversification of farms types. We assume that this situation is the consequence of some compromise that can help us to determine the process of transition and to make prospects on the future development of the Russian agricultural sector.

[1] This concept allows us to conduct a similar analysis of the FPI than the analysis developed by DRIES et al. (2009) to describe the transformation of the vertical coordination of the dairy supply chains in Central and Eastern Europe.

In the second section, we demonstrate that, through a stabilized productive configuration, multifunctionality helps to preserve a community of interest and improve the business activity of farms and that the nature of the multifunctionality in the agricultural sector depends, in fact, on the nature of the productive configurations that have taken place in each community.

2. MULTIFUNCTIONALITY OF RUSSIAN FARMS: A STYLIZED FACT REVEALED BY BOOKS

2.1. From the concept of CSR to the multifunctionality approach

In 2001, the OECD proposed a multifunctionality analytical framework. According to the OECD, it reflected externality and public welfare aspects of the various non-commodity outputs of agricultural production. Since then, multifunctionality has been considered as an activity-oriented concept that refers to specific properties of the agricultural production process and its multiple outputs. The exploration of the supply and demand characteristics for the positive and negative outputs of agriculture led the OECD to explore not only agricultural but also non-agricultural ways of supplying the non-commodity outputs demanded by society. The framework aimed to define when it was economically justifiable to substitute non-agricultural production with agricultural production of non-commodity outputs. This important issue aims to determine if some non-commodity outputs could be supplied at a lower cost by non-agricultural providers. In this context it is important to know whether the non-commodity outputs can be separated from agricultural production. The answer depends on transaction costs (which include economies of scale) and on the fact that some joint outputs exhibit the externality or public good characteristics. In fact, the point of view adopted by the OECD was to consider multifunctionality as a characteristic of agricultural production which legitimated maintaining some production of non-commodity outputs in the agricultural sector. Outputs such as the production of landscape, biological diversity and other territorial aspects were directly concerned. The report also stated that it did not take into account another aspect of multifunctionality as the OECD (2001: 14) indicated: "The second way of interpreting multifunctionality is in terms of multiple roles assigned to agriculture. In this view, agriculture as an activity is entrusted with fulfilling certain functions in society. Consequently, multifunctionality is not merely a characteristic of the production process, it takes on a value in itself". In this perspective, multifunctional activity can become a policy or a strategic objective. Our analysis will follow this second approach to multifunctionality.

2.2 Multifunctionality as a stylized fact

During the Soviet period, collective farms (kolkhozes and sovkhozes) acted not only as production units but also as social institutions, regulating a significant part of everyday life in the villages. The economic and social reforms conducted at the beginning of 90s, aimed at transfering these prerogatives to the local administration. The goal was to establish capitalist farms in the post-Soviet Russian countryside. Yet, year after year, geographers, political scientists and economists observed that this transfer did not succeed.

We identified three explanations for this situation in economic literature. Most economists put forward reasoning that reforms have not been correctly implemented; the consequence being the maintaining of barriers to entry that prevent individual farms (considered to be much more efficient) from developing (BROOKS and LERMAN 1994a, 1994b, BROOKS et al. 1996, EPSTEIN and SIEMER 1998, KAMALYAN and al. 1998, LERMAN 1996, 1997, 2001 and SEROVA and SHICK 2005). These barriers can originate from: inefficient economic rules, politicians' choices to protect former collective farms from bankruptcy, while in the run for coming elections (AMELINA 2000) and/or

from the cultural block of the rural population. Secondly, geographers such as PALLOT and NEFEDEVA (2007) support the idea that the preservation of inefficient activities of farmers is linked with a rational behavior of the rural population, anticipating the degradation of their conditions of life. And a third possible hypothesis is given by political scientists as O'BRIEN and WEGREN (2002), WEGREN (2005) who consider that even if traditional social prerogatives of agricultural enterprises do not disappear, the farms transformed themselves into more capitalist farms, which are underestimated.
While we do note some differences in our own explanation of why farmers have continued to provide extended packages of social services, according to most researchers thus far, this role has remained after transition. In accordance with the second explanation given, we can consider that this role is an aspect of the Russia's agriculture multifunctionality. We must then specify the nature of this multifunctionality.

2.3 Farm multifunctionality characteristics and their economic consequences

Nowadays, one of the most significant specificities of Russian farms is their role in providing social services for populations like kolkhozes and sovkhozes did in their time.
Some researchers consider that it is a remnant of the Soviet period due to political intervention, particularly in the case of corporate farms (AMELINA 2000). Yet, the choice of maintaining social responsibility is widespread among farmers and does not depend on the size of the farm, which is why it needs to be specified for each type of farm. For instance, RYLKO et al. (2008: 99) point out the fact that one of the general patterns observed in the emergence of agroholdings in Russia is that "some firms have attempted to provide extended packages of social services previously offered by collectives". In the same time, RYLKO et al. (2008) do not consider that these new operators have an irrational behavior. The main reason for entering the agricultural sector given by them is their attempt to make profit. Neither do O'BRIEN et al. (2004) consider that these objectives collide. In their opinion, the search for profit combined with the attempt to provide social services are the result of a hybridization process. The farms try to enter the market economy system, but their need for political or economical support leads them to reach a compromise between their interest and those of the rural population.

As far as individual farms are concerned, PALLOT and NEFEDOVA (2003) have demonstrated that they also fulfill a social function. For instance, they give a part of their production (mostly vegetables) to the rural population, in return for land. Moreover, BOGDANOVSKII (2008) established a link between the diminution of employment in the corporate farms and the increase of over-employment in the individual farms, as we can see on figures 1 and 2.

Fig. 1: Agricultural labor: corporate and individual farms

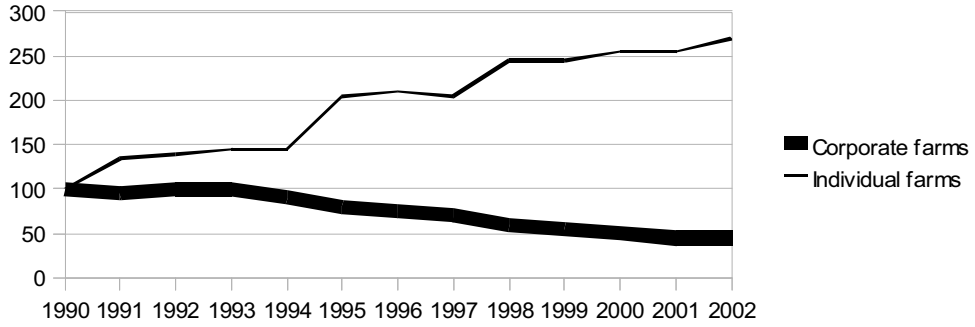
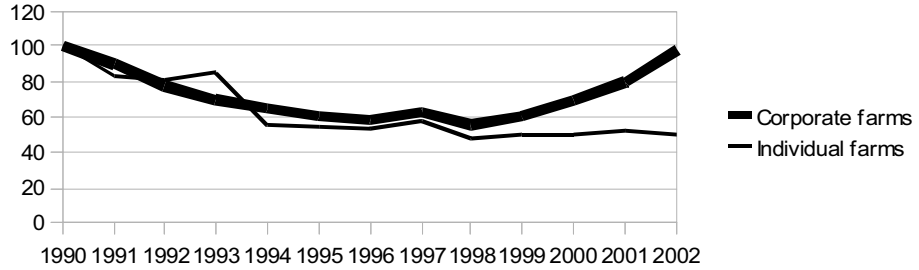


Fig. 2: Agricultural labor productivity: corporate and individual farms



Source : BOGDANOVSKII (2008 : 238)

Economic literature considers that individual farms are more productive than corporate farms due to the absence of economies of scale in the agricultural sector. Analysis of figure 2 shows the opposite tendency. In fact average labor productivity in Russia is lower in the individual farms than in corporate farms (see LERMAN and SCHREINEMACHERS 2005 ; LIEFERT et al. 2005 ; MACOURS and SWINNEN 2005 for similar findings). For BOGDANOVSKII (2005, 2008) this situation is the consequence of the absorption of the full impact of the lack of labor component in the individual sector. But, BOGDANOVSKII does not explain how individual farms keep their place in the market, with such bad levels of labor productivity. SWINNEN et al. (2000) go further and draw a parallel between the over-employment phenomenon in individual farms and the decrease in unemployment subsidies in various Eastern European countries. Moreover, O'BRIEN et al. (1998) have demonstrated that the more the individual farms are able to absorb the impact of the missing labor components, the more the corporate farms transfer their employees in the individual sector. When this is not the case, the transfer does not happen. There is the relationship between corporate farms and individual farms. PALLOT and NEFEDOVA (2007: 205) concluded with these words: "The strange thing is that it precisely this small-scale activity that is guaranteeing the continued existence of the former collectivist agricultural enterprises […]. They explain why collective farms have proved to be more stable than economist-reformers had earlier predicted".

At the same time, we observed that both individual and corporate farms are multifunctional. However, this occurs in different ways that do not have the same economic consequences. Corporate farms continue to make profit as well as fulfilling a need for social services whereas

multifunctionality has unfavorable consequences on individual farms and their productivity. Yet both types of farms remain. We will now study the institutional framework farms have developed to ensure their maintaining in a competitive context. We will demonstrate that the form multifunctionality takes emerges from compromise between farms and communities. Then we'll show how, more than a consequence, multifunctionality can be understood as differentiation or complement strategies in the development of farm activities and in the reproduction of communities of interests by the means of four different productive configurations.

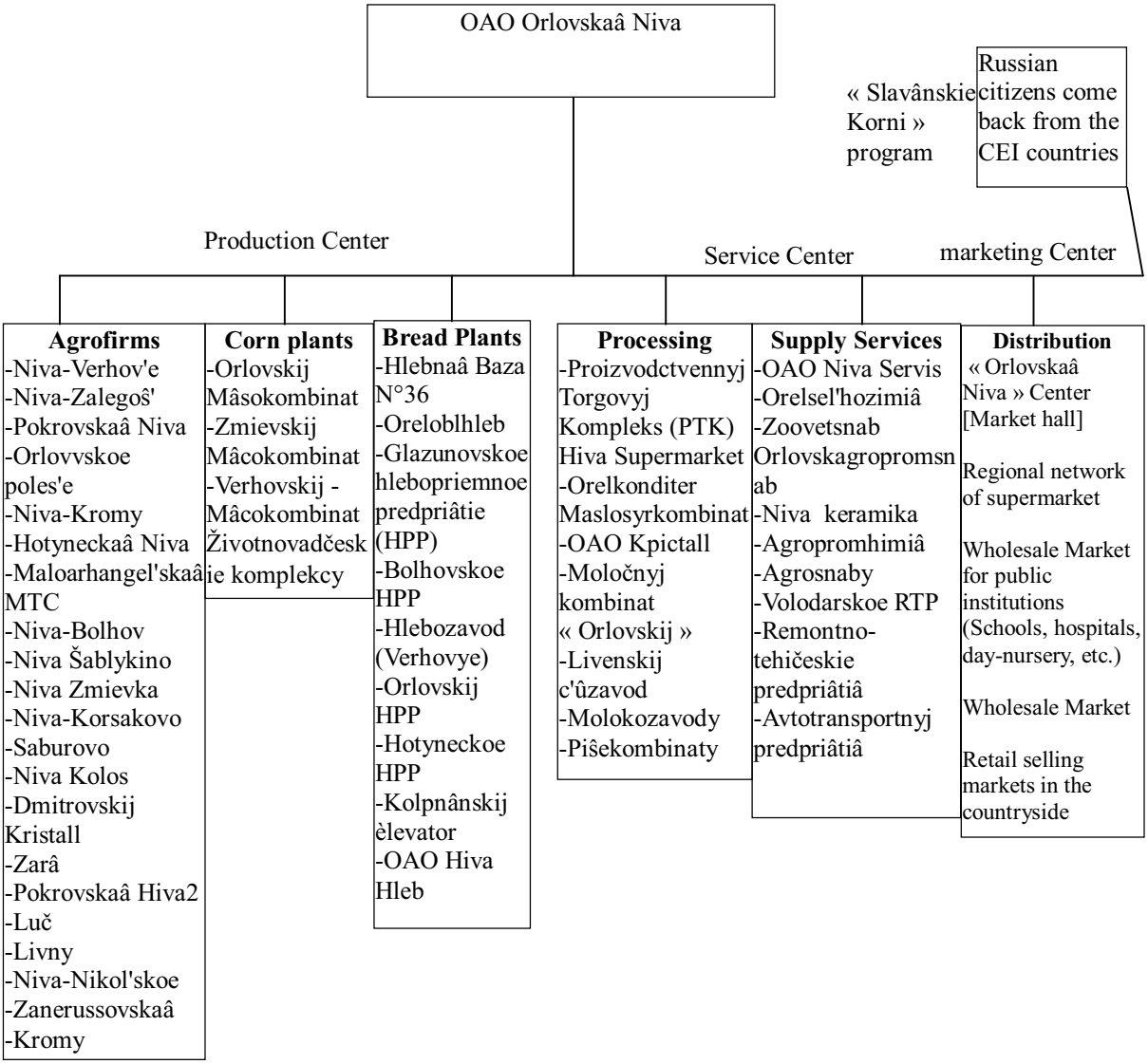
3. MULTIFUNCTIONALITY AS FARMERS' STRATEGIES TO DEVELOP ACTIVITIES AND TO REPRODUCE COMMUNITIES

We identified four “productive configurations” in the *régulation* of the agricultural sector of the Orel *oblast'*. The first one was developed by the Orel local government and emphasizes the food security and the zoning of the region by controlling some corporate farms and some private farmers. The second productive configuration was developed by new operators under the control of “oligarchs”. In this configuration two elements are linked together: the financing of some collective goods (primary schools, housing, etc) by the farmers in return for the favorable regulation of the food market by the regional and national authorities. This regulation takes the shape of quotas on meat importation or on facility access to credit for the oligarchs in the Orel *oblast'* against the food-industry. The third “productive configuration” allows the development of two types of farms: independent former kolkhozes/sovkhozes and plots of land. In this configuration, the independent farms find new outlets into the food-industry and help plots of land to get contracts with industrial operators. This type of compromise allows the fundamental needs of the local population to be guaranteed. The fourth productive configuration helps expand the activity of private farmers: they sign contracts with “*speculant*” (middlemen) to guarantee outlets for their products, avoiding the competition with corporate farms and food-industry. This configuration directly depends on the land contract that the private farmers sign with collective-land owners. Private farmers provide the collective-land owners with inputs for their plots of land in exchange for land rental.

3.1 The regional agroholding

In 1994, the administration of Orel *Oblast'* created one of the first agroholdings[2] in Russia, which subsequently disappeared in 2010. However, it is interesting to understand how it was organized. *Orlovskaâ Niva* was structured as a whole supply chain, integrating the entire production chain from basic agricultural products to foodstuffs. Therefore the organization integrated different kinds of firms, from corporate farms to food processing plants. The official goal of this organization was to reduce the bankruptcy risk of ex-kolkhozes and ex-sovkhozes. At the same time, it was playing a role in the food security of the region. Indeed, *Orlovskaâ Niva* used to produce all kind of foodstuffs consumed by Orel citizen as fig. 3 shows.

Fig. 3: Orlovskaâ Niva agro-food industry



Source: MCX (2001: 22)

[2] Initial analysis of the agroholdings were proposed by RYL'KO and JOLLY (2005). They defined agroholdings as commercial farms controlled by entities whose core business is outside agricultural sector. But WANDEL (2007) points out the fact that agroholdings can also be under the control of a regional authority. Then, according to the definition adopted by authors, agroholding appears more or less efficient (HOCKMAN et al. 2005, 2007). In this article we define an agroholding as an organization owned by public or private investors whose core business is outside agricultural sector in the aim to integrated farms into a supply chain. That means that the efficient of the agroholding as to be evaluated according to this goal.

As we can see in fig. 3, *Orlovskaâ Niva* also integrated some physical markets to ensure outlets. Furthermore, the managers of the agroholding had signed contracts with some owners of household plots and some individual farms, as reported by an Orel farmer in one of our interviews.

> I am a grain grower. I signed a contract with the administration of the Oblast'. I sell a significant part of my production to *Orlovskaâ Niva* on a price established before the transaction takes place. The price is lower than the market price. But the Orel administration gave me subsides to build my house.

For a long time the organization has included some individual farms, which helped processing plants secure their inputs. As a consequence, production in *Orlovskaâ Niva* has been extremely diversified. We interpret this diversification of the production as a will of the region's authorities to guarantee the typical food commodity basket. This hypothesis is consolidated by the declarations of the accountant of *Orlovskaâ Niva's* market hall:

> In Orlovskaâ Niva's market hall the delicatessen comes essentially from the agroholding's processing plants. On the other hand the meat results from contracts signed with individual farmers. We can thus buy everything on our market but the origin of products is diverse.

According to this statement Orlovskaâ Niva not only integrated former kolkhozes and sovkhozes but also individual farms that supplied it with market garden produce at prices lower than market prices. In return, these farmers received subsidies from the public administration to build their housing. *Orlovskaâ Niva* performed a social role, which gave strong reasons for farmers to become part of the agroholding. Access to housing appears to be a characteristic of agroholdings' multifunctionality. In the case of Orel, this non-market welfare service appears as a mean to secure the food supply for the regional agroholding.

As seen in this example, the *commercial relationship* in which the actors of this productive configuration are placed obliges individual farmers to supply foodstuffs at a non-market price whereas the *patrimonial relationship* induces *Orlovskaâ Niva* to offers access to social goods.

3.2 A productive configuration of "private agroholings"

During our stay in Orel we conducted interviews with managers of Nobel-Ojl, Eksima, Ûnost and Moslovo, which are private agroholdings set up in this *Oblast'*. Interviews enabled us to learn that these structures adopted a sectoral integration framework, from agricultural raw materials to the retail food market. Their food production is more specialized than the public agroholding's production.

The table 1 below proposes a summary of the private agroholdings listed in the Orel *Oblast'* in 2007/2008, according to information gathered from our interviews and from extensive data from the agricultural department of the regional administration.

Table 1: Agroholdings in the Orel Oblast' in 2007/ 2008

Head office of the agroholdings	Name of the owners	Usable farmland in ha.	Investment in 2007/ 2008 (Md. r.)	Mean activity/Activity in Orel	Number of Corporate Farms in Orel
OAO Agrofest-Don (OOO Agrofest-Orel)	Aleksej Fedoryčev (Dinamo of Moscow)	31000	0,134	football/grain production	10
Mossel'prom (in 2009)	Sergej Lisovsko	n.a.	n.a.	Television and press/Pig breeding	3
Agroholding (AMS-Agro)	Četverikov	30000	2	Politician/ n/a	9
Belyj Fregat	Anatolij Butorin	100000	1,3	Grain Import /Poultry farm	5
ZAO AVK Eksima (Eksima Agro) . The shareholder is the company Soûzagrozagranpostavka	Nikolaj Demin	46000	4	Meat international trade /Pig breeding	4
Set-Holding (link to OAO "Severnaâ Neft'" bought by Rosneft)	Aleksandr Samusev	50000	0,004	Oil/grain production	4
Agroteh-M	Žanna Mahova	8500	1	Oil/Daily cow breeding	3
Nobel-Ojl (Nobel-Agro)	Grigorij Gurevič	90000	0	Oil/grain production	3
OOO Planeta	Perelygin Gennadij Leonidovič	8800	0,016	n/a /Daily cow breeding	2
Agriko (Šablykinskij agrokompleks)	Vladimir Bovin	6000	4	International Trade of Grain/Pig breeding	2
holding ZAO Orelinvestprom	Il'âžov M.A.	40000	6,5	Cement works/Pig breeding	2
Avtobaza Il'inskoe	V. P. Veŝikov	9500	0,03	Construction firm in Moscow/Potato	2
Al'kor Holding grupp AG – russo-swiss Bank (Avangard Agro-Orel)	Vladimir Džangirov	11200	1	Bank/sunflower oil	1
Prodimeks Holding (bought 51% of the company "Kompaniâ Evroservis")	Hudokormov Igor' Vâčeslavovič chairman of the company RAZGULÂJ	14400	n.a.	Sugar import from Ukraina/Sugar manufacturing	2
Holding Zolotoj Kolos	n.a.	2600	0,059	Regional agroholding from Tatarstan	1
OAO «Agropromyšlennyj al'âns Ûg»	Isaenko Petr Dmitrievič	8000	1,4	n/a / Pig breeding	4
Moslovo	Aleksandr Dragal'cev (nephew of the governor Stroev)	35000	-	dairy cow breeding and market gardening	2
Ûnost'	Sergej Boudagov (Brother-in-law of the governor Stroev)	2200	-	Grain production	1
OOO Omega Kompaniâ	Karmanov Konstantin Nikolaevič	4300	0,45	Nd./dairy cow breeding	1
Total	*41 % of the regional usable farmland*	*487200*	*22*		*58*

The private agroholdings occupy an important land area in the region of Orel. In 2007/2008, private agroholdings owned 58 corporate farms, representing approximately 20 % of the total of the corporate farms in this region. These 58 corporate farms occupied 41 % of the agricultural land area. Moreover, The private agroholdings invested 21,4 billion roubles (approximately 630 million euros) in modernizing farms. We chose to describe how one of these agroholdings in particular works: Eksima-Agro.

The economic model of Eksima-Agro

Eksima-Agro is an agroholding owned by Soûzagranpostavka, a company specialized in the international meat trade. During the Soviet period this company guaranteed most of the meat supplies of the USSR. In 1992, Soûzagranpostavka created Eksima with the aim of pursuing its trade activity. This allowed it to take part in the federal initiatives of foodstuff deliveries for the needs of the Moscow administration. Eksima works, for this reason, with important Russian banks such as Rossel'hozBank, GaspromBank and Sberbank. Also, Eksima bought the most important delicatessen plant of Moscow (Mikoân, 20 % of the Moscow delicatessen market) and supplied it thanks to its international trade activity. In 2006, Eksima modified its strategy, taking control of four corporate farms from Orel *Oblast'*. These farms are specialized in pig breeding and have allowed Eksima to supply its delicatessen plant since then. In 2009, the agroholding encompassed twenty corporate farms or factories and about 10 000 employees. The pig population was 70,000 heads. The agroholding owned 46,000 hectares (113,700 acres) of land among which 36,000 hectares (89 000 acres) were used to provide feeding for the pig breeding farms. When we asked Natalia Viktorovna (the regional manager of Eksima-Agro) which part of the pig-feed was bought, this is the answer she gave:

> We buy 100 % of the feed.
>
> *Question: this sounds astonishing to me because most of the pig breeding factories I met use their own feed. Why don't you adopt the same policy?*
>
> In fact, we have the same policy: we buy feed from corporate farms which are integrated in Eksima-Agro. It is the head office of the agroholding that sets the prices. [...] the prices are factually lower than the market prices. Our objective is to have control of the supply and of the prices in all the supply chain processes.

The feed production of the corporate farms (which was estimated at 760 million Rubles in 2009 by the local manager of Eksima) aims at satisfying feed needs of the agroholding. The manager's comment on the feed-price formation proves that the contracts with the corporate farms are not contracts signed in a competitive context. These non-market contracts are signed because of the integration model developed by the agroholding. Also, if relations between the pig breeding factories and the "Mikoân" plant can be considered as business connections of independent legal entities from a legal point of view, the reality is that they are not market based relations, yet. The pig breeding factories sell their meat to a price determined beforehand by Mikoân. The agroholding controls all the supply chain prices, from the feed prices to the delicatessen prices. The market is pushed to the level of a high value-added end product such as the delicatessen.

The vertical integration practiced by Eksima is the new organizational shape developed by most of the agroholdings we interviewed. It allows costs control over the whole supply chain and production system. Moreover, Table 1 (above) reveals that these agroholdings specialize in high value-added activities which provide fast ROI. They focus mainly on poultry/pig breeding and feed growing activities. The poultry and the pork meat are then pre-packaged in sealed containers before being sold in supermarkets.

In contrast to the public agroholding, the private agroholdings adopt a commercial trade strategy. Nevertheless, these firms supply and\or finance collective goods and welfare for their employees and for the inhabitants of the villages. According to data obtained with an agriculture specialized economist of the Orel *Oblast'*, in 2008 Eksima spent 75 million Rubles (2.1 million Euros) in housing, roads, gas networks and subsidies to public schools and care centers in the Olorvskii *rajon*. In 2006, the company Jupiter (controlled by the OOO Omega Kompaniâ, see Table 1) built houses and financed a playing field for the middle school of the village of Zlynski. The firm spent 400,000 Rubles (10,000 Euros) on the acquisition of computers for the benefit of the same middle school.

These examples underline that the leaders of agroholdings agree to perform social roles for the benefit of the rural population. Two elements encourage them into this initiative: incentives from the authorities and the fact that financing collective goods is a means to stimulate the productivity of their own employees. This answer by a Moslovo manager (see Table 1) to the question *"do you use other means to stimulate the level of productivity of your workers?"* illustrates this perfectly:

> Yes, by providing social insurances, assistants of all kinds, which I call the "employee relationship management". I help them obtain bank loans for house building. How I assist them is determined by their behavior patterns: the best employees get the best services. It is a pre-capitalism.

In this case multifunctionality take a specific form and seems essential to guarantee good everyday living conditions, particularly in the countryside where the corporate farms are probably the only institutions able to finance such investments (LEFÈVRE 2003).

3.3 A productive configuration framed by independent corporate farms and actors of the Food-processing industry (FPI)

In 2008, thanks to extensive data gathering, we estimated the number of independent corporate farms in the *Orel Oblast'* to be 196, which is approximately 70 % of all the corporate farms in this region. We use the terminology of "independent" to qualify corporate farms not having exclusive subordinate relationship with public or private agroholdings. As a consequence these farms have to find the means for financing their investments and to look for outlets by themselves. They have limited access to bank loans, and thus increased difficulty in modernizing their equipment and expanding their activities in the value chain. As a result, the independent corporate farms prove to be dependent on the food-processing industry. The productive configuration set up by the independent corporate farms revolves around contracts signed with FPI actors.

A representative case can be found with the company Novosil'skoe in the Orel *Oblast'*. This company has to look for its outlets by itself. In this context, Novosil'skoe signed a contract with a dairy factory in Tula, the administrative capital of a neighboring region of Orel. Novosil'skoe sells 90 % of its milk production to this factory. Moreover, the local household plots benefit from this commercial contract because the factory not only collects milk from the corporate farm every morning but also the milk produced the household plots.

This kind of productive configuration has been confirmed by interviews we had with thirty managers from the FPI at Prodexpo 2009 (a Moscow agro-industrial fair). This study allowed us to note that six FPIs specialized in dairy production got their supplies from independent Russian corporate farms. Other FPIs privileged import of foodstuffs (from Europe, the United States, the CIS, and South America). In the case of the ONO Lovosil'skoe, the contract signed with the Tula FPI is a yearly contract which set the price of milk at 8 Rubles per kilogram (i.e. 0.19 Euro per

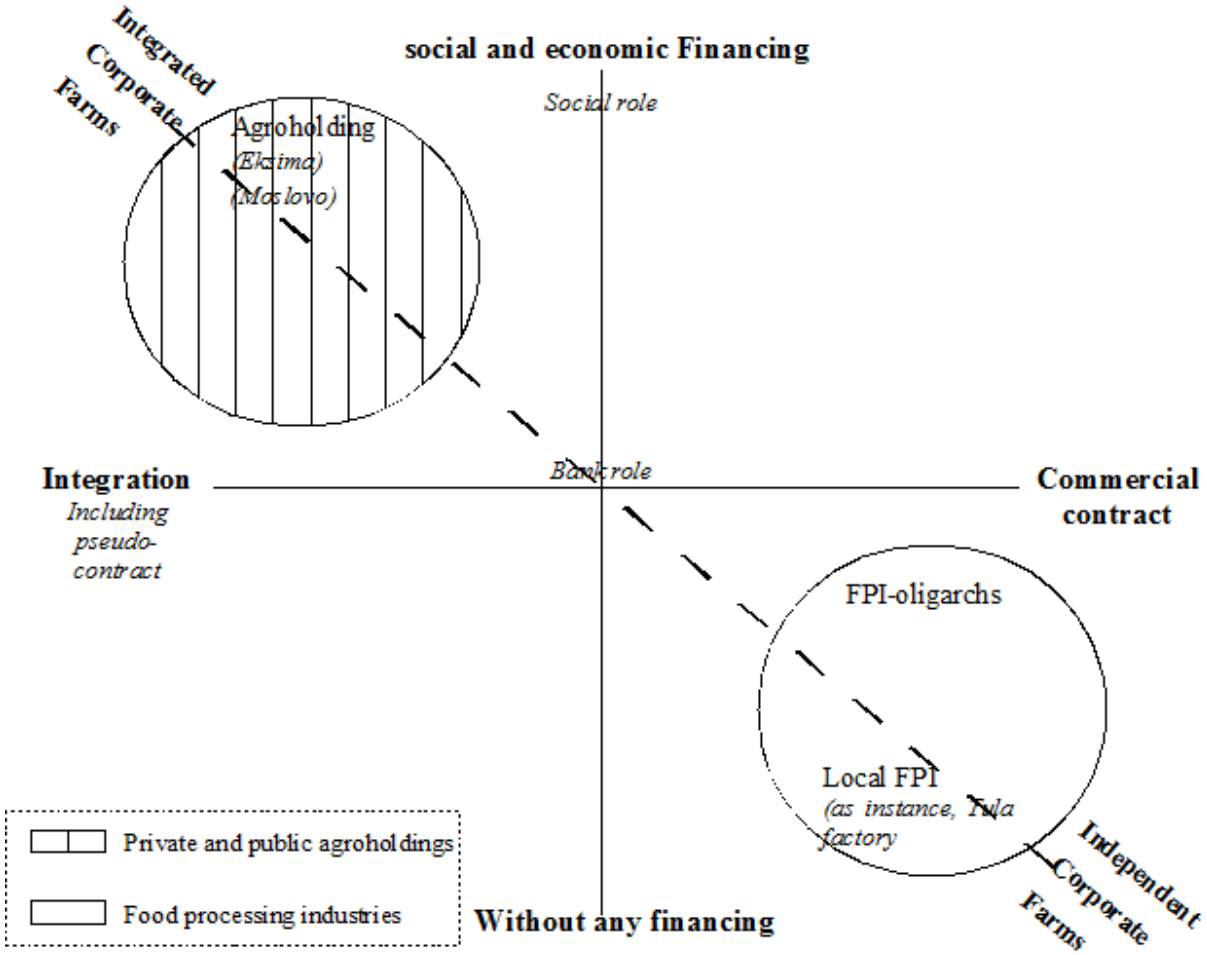
Kilogram) for year 2009.

The contract with the factory is only a trade contract. However, it allows ONO Lovosil'skoe to have a *patrimonial relationship* with the owners of plots of land. Indeed, Lovosil'skoe gives the benefit of its commercial contract with the Tula factory to the household plots, enabling them to sell their production to the factory, while without the 918 tons of milk of the independent corporate farm, the factory would not come to take the milk of the small producers. In fact, the ONO Lovosil'skoes obliges the factory to set a single price for the milk. We used the word of "*krysa*" (krysa means roof in Russian) to name the protective role played by the corporate farm for the household plots. This term makes reference, in the business field, to all the knowledge and the organizations which are able to ensure, secure and stabilize business environment in a particularly highly corrupted context.

Generally speaking the corporate independent farms sell their outputs thanks to the FPIs. But, the latter concentrate on importing foreign products to get their supplies (especially for meat). In contrast to the private agroholdings behavior models, the Tula factory does not enter in a *patrimonial relationship* with the corporate independent farm. It is the independent corporate farm who enters in *patrimonial relationship* with the household plots by letting them benefit from its commercial contracts with the factory.

Box No. 1: Typology of the corporate farms according to their relationships with investors

Through both the productive configurations of "private agroholdings" and "independent corporate farms – FPI", we are able to give a representation of the transition of 90 % of the former kolkhozes and former sovkhozes of the Orel *Oblast'* (the remaining 10 % concern farms integrated into public agroholding or those we were not able to determine the nature of the subordination). The graph bellow represent the nature of the relationships between investors and corporate farms.



The X axis represents the nature of the contract signed between a farm and its investor/partner. When the commercial relationship is set within a hierarchical model (with acquisition of holdings in the share capital of the corporate farm by the investor/partner) we use the term integration. In association with this term, we use the term of "pseudo contract" to name contracts between the integrated corporate farms and agroholding partners but at a price which isn't market determined. On the other end of the axis we use the term "Commercial contract" to characterize the commercial relationship between FPIs and independent corporate farms, based on market economy.

The Y axis characterizes the social and/or commercial commitments undertaken by the investor.

The graph underlines an important result of this article, which is the relationship that exists between the degree of integration and nature of the social commitments undertaken by the oligarchs. In the Orel *Oblast'*, the takeover of the corporate farms by oligarchs leaded to the financing of collective goods.

3.4 The productive configuration of individual farmers

In the category of the individual farmers we include farmers and owners of plots who have a commercial activity independent of public or private agroholdings and of independent corporate farms. It is impossible to give the exact number of individual farmers in the Orel region. In fact, the official data records the number of farmers and household plots but do not specify which ones among them chose to join agroholdings and those who stayed independent. But, the concentration of corporate farms in the hands of oligarchs is not without consequence on the strategic choices brought by the individual farms of Orel.

We interviewed twenty-five farmers and household plot owners with a clear commercial orientation. Of those twenty-five, only three sold their production themselves on a physical market where they have a dedicated stand. All others sold their production by means of middlemen; a choice that can be considered as an opportunity to get markets without having to manage too many relationships (commercial or patrimonial) on their own either with public or private agroholdings and/or FPIs. Middlemen are at the core of the commercial strategy for individual farmers. An economist from Orel we questioned on this subject made the following statements:

> *I would like to discuss with you the specific situation of the individual farmers. During interviews with them, I asked how they sold their produce. Most of farmers told me that they resorted to middlemen to sell their production. How do you explain the success of the middlemen?*
> Usually, the middlemen are traders.
> *But is there any link with an agroholding?*
> No, not usually.
> *Then, they are only...*
> Parasites
> *Why parasites?*
> Because they buy products at a lower price than market price. But I admit to being a little sarcastic. Middlemen come to farms and take the products to ensure they get sold. It is already a very good thing for the farmers, as they lack information concerning the outlet places while these middlemen know it. I cannot say that they are indeed parasites, because they play an important role: they put farmers' produce on an asymmetric market. If the farmers had enough knowledge about how the markets work, they would not need to resort to these middlemen. But, as it is not the case, the middlemen clear up the difficulty of the asymmetric information.

After the produce is sold to the middleman, individual farmers know nothing about the transformation process of their produce. We interpret this situation as both an institutional arrangements and a strategic choice of the individual farmers to avoid direct competition with other farmers. The individual farmers won't be able to look for outlets by themselves because of the competition with the agroholdings whose high level of production is far more interesting than the low ones of individual farms for the FPI.

Yet, the individual farmers are not excluded from any *patrimonial relationship* especially with the community of landowners. They are able to produce because of land contracts they have signed with the landowners from the local communities. They give part of their produce to the landowners, collective goods and even employment in return for the right to cultivate their plots. This is an explanatory factor as to why individual farms have lower labor productivity than corporate farms. The commercial independence of the small producers depends on the *patrimonial relationship* they establish with the rural community.

4. THE TERRITORIAL REGULATION OF THE FOUR PRODUCTIVE CONFIGURATIONS

The identification of the four productive configurations tells us that legal, economic and financial situations of farms are very diversified in the Orel *Oblast'*. However, the integration of the farms into one of the four productive configurations never draws them completely away from market competition. Actually, the competition is generally transferred from the agricultural market to the food processing market. As consequence, competition does not take place between farms themselves but between the four types of productive configurations. The lack of food specialization in the public agroholding; the choice of the private agroholdings and FPIs to produce similar foodstuffs (with fast return on investment) leads to high competition within this market with advantages and drawbacks for each configuration. Only the strategy of the individual farms consisting of selling to middlemen seems to keep small producers away from this competition.

In this context, the specific characteristics of multifunctionality for the public and private agroholdings generates an over-cost compared to the costs supported by the FPIs, the later having only *commercial relationship* with the independent corporate farms and benefiting from "subsidized" prices for imported goods from Europe or the United States.
We are now going to describe the regulation as it has been developed in the Orel *Oblast'* to allow preservation and development of each of the four productive configurations.

4.1 The regulation of the meat market

The first regulation concerns the meat market, and specifically the poultry and pork markets. Because poultry and pork benefit from fast return on investment, they are the preferred produce of private agroholdings.
In 2003,the Russian Parliament passed a law establishing quotas and contingents for meat imports. This decision was due to the increase in these imports the 1998 financial crisis, which was increased by the FPI in an attempt to reduce their foodstuff production costs.
On the contrary, Russian producers (particularly the leaders of the agroholdings) pushed the Russian government to take measures to protect the national market (HERVÉ 2007). That is why the regulation of the meat market has been set as a double protection: a system of quota on poultry imports since 2003 and a tariff contingent system for beef and the pork since 2006. It is relevant to note that the production of private agroholdings principally consists of poultry, which explains, in our opinion, why the poultry market was the first market to benefit from a quota. These protectionist rules seem to have had good consequences for the agroholdings declares the director of the Migratorg agroholding:

> *Did Miratorg take care of the pig breeding thanks to the introduction of import quotas?*
> It is an essential factor which encouraged us to invest in the agricultural sector. For us, this was a sign that the government had come from campaign promises to concrete actions, and supported Russian production. To enable fast replacement of the meat import by national production, it began by the fastest market in terms of ROIs: poultry farming. Then, the government favored the development of pig breeding as well.[3]

The system of quota and tariff contingents seems to be an instrument of protection of national production mainly defended by directors of private agroholdings.
In the Orel region, the quota system also brought a new clean sheet in terms of food security

[3] Agroinvestor n°5 may 2009, downloaded may 5th 2011, http://www.agro-investor.ru/issue/69/3128/

policies. Carried by the devaluation of the Ruble which followed the 1998 crisis, the Orel regional administration knows how to take advantage of the renewed interest of the oligarchs in the agricultural sector and how to encourage new investments. Since 2003, the quota system has become an additional instrument in territorial promotion of farming activities. Table 2 reports the evolution of poultry production.

Table 2: Poultry production in the Orel Oblast' (tons) according to the category of farms

	2001	**2002**	**2003**	**2004**	**2005**	**2006**
Farmers	17	34	42	39	48	38
% of the regional production	0.33	0.48	0.44	0.36	0.34	0.28
Plot of land	2700	3300	4200	4600	4900	4600
% of the regional production	52.77	46.91	43.56	42.05	34.88	33.73
(independent or integrated) Corporate farms	2400	3700	5400	6300	9100	9000
% of the regional production	46.9	52.6	56	57.59	64.78	65.99

Source: ROSSTAT (2007a: 22), ROSSTAT (2007b: 20) and ROSSTAT (2008: 30)

In the Orel *Oblast',* the share of poultry production in the farms rose from 47 % in 2001 to 66 % in 2006. Although the production of small producers also increased, their share in the regional production decreased between 2001 and 2006, from 53% to 34% as the global volume of production exploded. This data reveals the development of the poultry production trend in the corporate farms. With the help of information collected from the corporate farms of the Orel *Oblast'*, we can state that five corporate farms produce all the poultry of the corporate farms category, which equates to 8,074 tons of poultry meat in 2007.
These five corporate farms are: the OAO Orlovskij Brojler (which belongs to agroholding Belyj Fregat, see Table 1), OAO Orlovskij Lider (which belongs to agroholding AMS-Agro, see Table 1). These two farms produce 7,643 tons of poultry meat, i.e. 95 % of the regional poultry production by corporate farms. Third place goes to ZAO Berezki with 290 tons in 2007 (we were not able to determine the productive configuration of this farm, so we can't tell if it is independent or not) and fourth place belongs to the ZAO Pticefabrika Orlovskaâ agroholding, which is integrated within the regional agroholding Orlovskaâ Niva (134 tons). Finally, in fifth place comes a corporate farm of which we ignore the productive configuration, and thus its dependence status. None of the independent corporate farms identified have participated in the production of poultry meat in the Orel *Oblast'*. To our knowledge, the production of poultry meat appears to be a specific product of the corporate farms owned by agroholdings.

4.2 The credit market

Another market allows the agroholdings to benefit from a competitive advantage compared with the FPIs. It is the credit market. The “national priority project for the development of the food-processing industry” set up a three-tier financing system in 2006:

(1) A support for animal breeding, which aimed to increase the production of meat and milk

respectively by 7% and 4.5% during period 2006-2007 thanks to preferential loans ;

(2) Subsidies to the small producers in the form of loans and technical support;

(3) Access to housing in the rural areas for the young graduates of the agrarian universities.

An analysis of the Orel regional budget reveals a positive global evolution of subsidies for the corporate farms since 2006. Yet, an analysis of grant allocations shows that it is mostly the integrated corporate farms that benefit from these subsidies. This is a list of the main subsidies and grants beneficiary in 2006 in the Orel *Oblast'*: the OOO Znamenskij SGC companies (for the purchase of 290 pigs), the OOO MTS-Zmievka (for the construction of a pig breeding facility), the OAO Agrofirme Livenskoe Mâso (for the reconstruction of a cow breeding facility), the OAO Plemzavod Sergievskij, and the OAO APK Orlovskaâ Niva (for the construction of a new poultry farm). All of these corporate farms are owned by private agroholdings with the exception of the APK Orlovskaâ Niva which belongs to the regional agroholding.

5. DISCUSSION

The productive configurations are organized in a different way. The public agroholding chose to integrate very heterogeneous farmers (farms, household plots, farmers). Rather than specializing in a type of production, the managers of Orlovskâ Niva preferred to specialize in producing higher-valued products through the integration of processing plants and market halls. Its production is linked to the consumption of the regions inhabitants (bread, meat, vegetables, etc.). The productive configuration established by the oligarchs concentrated on high value-added products (by integrating all elements of the value chain from producing to selling foodstuffs). On the contrary, the independent corporate farms signed commercial contracts with the FPI to sell low value-added products. Finally, the individual farmers preferred to limit their implication in market competition with the other productive configurations by hiring of middlemen. These organizational strategies come along with specific *commercial and patrimonial relationships* in each configuration. We summarize these relationships in the Fig. 4.

Fig. 4: The four productive configurations in the Orel *Oblast'*

	public agrholdings				private agroholdings		
	corporate farms	individual farms	household plots	Agroholdings	corporate farms	oligarchs	
commercial relationship	to deliver products to the agroholding at a lower price than the market price			competition with other PC on the local market	to deliver products at a lower price than the market price	competition with the FPI on the foodstuff markets	
patrimonial relationship	collective goods	housing for young people		(1) food security (2) collective goods	collective goods	to apply a social policy to the countryside	
local and federal regulations	(1) access to credit	(2) credit for housing projects		access to credit from regional banks	access to the credit market	(1) access to credit from regional banks	(2) quotas
	food processing industry				small producers		
	corporate farms	household plots	middlemen	FPI	individual farmers	household plots	middlemen
commercial relationship	to deliver products at the market price		improve the competition between farms to the benefit of the FPI	competition with private agroholdings on foodstuff markets	Competition with other farmers	competition with the other household plots	(1)encourage the competition between small producers to knock down prices (2) find outlet opportunities
patrimonial relationship	play a kryša role		avoiding the competition with the corporate farms	n.a.	to deliver inputs for the landowners	n.a.	Reproduce the identity of the small producers
local and federal regulations	n.a.		n.a.	unfavorable quota policy	n.a.	n.a.	n.a.

P

Public and private agroholdings force the integrated corporate farms to enter into an unfavorable *commercial relationship.* This relationship consists of buying products at prices lower than market prices. But at the same time, the agroholdings have a *patrimonial relationship* with the farming communities of workers by supplying them with collective goods. This behavior shows how multifunctionality of the corporate farms in the Orel *Oblast' organizes* but does not prevent the managers of the corporate farms conditioning the access of the collective goods to the level of productivity of their employees. The difference between private and public agroholdings is put on the public agroholdings' interests for the food security issue.

The independent corporate farms and the FPIs only maintain a *commercial relationship*, the latter buying non-transformed products from farms at market price and selling transformed foodstuffs. However, the independent corporate farms play a role of krysa, thus fully assuming the *patrimonial relationship.*

Finally, the small producers enter into an unfavorable *commercial relationship* with middlemen. However, the individual farmers have a *patrimonial relationship* with the rural community of land owners. They are supplying them with a part of their production in return to a land access (Grouiez, 2008).

These four productive configurations lead to a regulation of competition, which give priority to the oligarchs (owners of the private agroholdings) both in regards of the quota policies and access to credits. We interpret this regulation as a mean to preserve institutional hybridization between commercial and patrimonial relationships brought by integrated corporate farms.

Without this sectoral regulation the private and public agroholdings would be forced to limit their multifunctionality to compete with the factories of the FPI sector. At the same time, their choice to be multifunctional can appear as a strategy allowing lobbying and as a move to negotiate access to

loans and protective quotas.

However, this regulation must be analyzed in dynamic terms. Nothing is set permanently as far as the four productive configurations are concerned. Their modification depends on the economic landscape of an area and the period of time. In the Orel *Oblast'*, ever since oligarchs invested in the agricultural sector, a transfer of integrated corporate farms within the agroholding Orlovskaâ Niva towards private agroholdings took place. As a result of this, private agroholding Ûnost bought Orlovskaâ Niva in 2010. However, a two years moratorium was signed with the regional administration, regarding the restructuration conditions of the former public structure. This tends to prove that the regional administration is not inclined to completely give up on the food security role that was performed by Orlovskaâ Niva.

6 CONCLUSION

We identified four cohabiting "productive configurations" thanks to regulation in the agricultural sector of the Orel *oblast'*. The first one has been developed by the Orel government: The government emphasizes food security and the zoning of the region by controlling some corporate farms and private farmers. The second productive configuration was developed by new operators. In this configuration two elements are linked together: the financing of some collective goods (primary schools, housing, etc) by the farmers in return for the favorable regulation of the food market by the regional and national authorities. This regulation comes in the form of quotas on meat importation or on facility access to credit for the oligarch in the Orel *oblast'* The third "productive configuration" enables the development of two types of farms: independent ex-kolkhozes/ex-sovkhozes and plots of land. In this configuration, the independent farms find new outlets into the food-industry and help owners of plots of land to get contracts with industrial operators. This type of compromise guarantees the fulfillment of the local population's basic needs. The fourth productive configuration helps to expand the activity of private farmers: They sign contracts with "*speculant*" (middleman) to guarantee outlets for their products, avoiding direct competition with corporate farms and food-industry. This configuration is also dependent on the land contract that the private farmer signs with collective-landowners. Private farmers provide the collectivity of landowners with outputs from their plots of land in exchange for rental land.

Indeed; each productive configuration is a result of strategies led by farmers in a highly competitive context. These strategies concern the multifunctional farm practices. The level of social investments for farmers differs across productive configuration. For instance, the farmers involve in the productive configuration of the food processing industry do not finance any social welfare for rural population (but, as we just mentioned it, help owners of plot of land to sign contracts with food-industry). On the other side, the farms integrated into private agroholding have special funds to finance social policies for rural area. In the same time, the multifunctional farm practices seem to be a determinant of the public regulation of the agricultural sector in Russia. In consequence, social policies of farms cannot be separated from their economic development strategies.

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